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Public Hearing

The Role of Lawyers, Accountants and Bankers in Panama Papers - (Part I)

Tuesday, 24 January 2017 (9h00 - 12h30)
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Brussels

Written questions

to Brooke Harrington, Associate Professor Copenhagen Business School. Author of "Capital without Borders, Wealth Managers and the One Percent"

1. Can you provide us your views on the role of wealth managers in tax evasion, tax avoidance and money laundering activities?

   The whole offshore finance system hinges on the work of wealth managers. Without them, the whole system—and tax avoidance of $200 billion globally each year, as estimated by Gabriel Zucman—would cease to exist. There would still be tax avoidance, but nowhere near on that scale.

   As for illegal activity like tax evasion and money laundering, no reputable wealth manager gets involved in those things. And it's not just a matter of morals: their reputation for discretion and dependability hinges on their staying on the right side of the law. They may be on the right side just by the tiniest margin, but it's essential that they stay "clean," legally speaking, or else most wealthy people will have nothing to do with them.

   The slogan of one wealth management firm, "I want to be invisible," not only encapsulates what the clients of wealth management want, but what the whole

industry tries to achieve. People engaged in illegal activity are constantly in danger of making themselves (or their clients) visible—even if they are never arrested or convicted, merely being exposed is the kiss of death, the end of legitimate clients and business. So most practitioners are very careful, out of self interest, not to get entangled in breaking the law.

That doesn't mean wealth managers don't violate the law in spirit—that happens all the time. But most practitioners take great care to comply with the letter of the law, to the point that the profession is often mocked or disparaged within financial services as being too cautious and compliance-oriented.

2. What are the instruments (e.g. offshore banks, shell corporations, trusts) used to hide private wealth not only from taxation but from all manner of legal obligations? How are such instruments used?

   There are three primary tools of wealth management: the corporation (need not be a "shell"), the foundation, and the trust. The first two will be familiar to most people; the last of the three may not, since it comes from Anglo-Saxon law. The trust is, arguably, the most powerful and most dangerous of the three tools, since it is the least transparent. (For more, please see my article on trusts: https://works.bepress.com/brooke_harrington/44/).

   The three structures are used in combination to obfuscate ownership of assets, making it practically impossible to assign legal responsibility for taxes, debts and other legal obligations. Many offshore jurisdictions create special laws just to enhance the obfuscating potential of these structures; this is the basis for much inter-jurisdictional competition in the offshore world.

   As for specific configurations of the three structures, they are as varied as the constructions that can be made from Lego bricks: from the simplicity of the basic building blocks, tremendous complexity can arise. The greater the complexity, the more time-consuming and costly it is to establish true ownership and responsibility. This is the key strategy—not law-breaking, but using the law to create all-but-impenetrable barriers to ownership identification. For more details on how corporations, foundations and trusts are used in the real world to hide wide, please see chapter 4 of my book, Capital without Borders: http://www.hup.harvard.edu/catalog.php?isbn=9780674743809

3. What is the result of the self-regulating status of legal/tax advisors, in terms of the effectiveness of the disincentives for intermediaries engaged in operations that facilitate tax evasion and tax avoidance?

   I don't understand the question. Could you rephrase?

4. Would you say that it is necessary to regulate intermediaries such as accountants, lawyers, bankers and wealth managers further? Please specify.

   No, I don't think additional regulation of the intermediaries themselves would help.

   The problem is structural conflict of interest, rather than lack of regulation. Right now, wealth managers are put in a highly conflicted position that is, in my opinion, untenable and doomed to fail.

On the one hand, they are required to act as the front lines for law enforcement in that they must certify that any clients that take on prove their identity as well as the legitimate source of whatever funds they wish the wealth manager to administer; they are to refuse anyone who is unable or unwilling to present this evidence.

Of course, wealth managers have their own (and their firm's) reputation to protect; no reputable professional wants to risk tarnishing that reputation by taking on criminals as clients—that scares away the good, law-abiding clients, in addition to bringing a host of legal troubles. But what of the marginal cases, or the cases where a client is perfectly legitimate, but simply refuses to disclose the information demanded of him or her? This happens a lot, since wealthy people from many parts of the world have well-founded concerns about their privacy and safety: they come from countries where authorities and institutions are not to be trusted, and when you ask them to show all kinds of documentation about themselves and their wealth, what goes through their mind are scenarios like kidnapping and extortion of themselves and their family members.

So many of the wealth managers I interviewed said that when they demand things from incoming clients that might seem simple and reasonable—like proof of identity and residence—they get clients who just say "no way" and move on to another firm…and there seems to be no shortage of firms willing to accommodate them.

This creates an obvious conflict of interest with the business obligations of the wealth managers: they may lose their jobs if they are "too rigorous" in conducting these KYC (Know Your Client) investigations.

In addition, once a wealth manager takes on a client, the professional must also keep an eye out for any illegal financial activity by their client (such as money laundering). However, the wealth manager may be working in a jurisdiction where blowing the whistle on any suspected illegal activity by a client is a civil offense—potentially a criminal offense.

So wealth managers are already caught, in some places, between conflicting legal imperatives. That's in addition to the conflict between economic incentives to take on clients, with the legal incentive to turn them away.

More regulation on top of this won't be useful, in my opinion. Instead, what's needed is a change in the structure of incentives for and demands on wealth managers. I'd recommend looking at the case of the Israeli tax authorities and how they "coopted" their country's wealth managers with some structural changes to demands and incentives.

5. Were you surprised by any of the methods for tax evasion or secrecy seeking as revealed in the Panama Papers? Did the Panama Papers reveal something new for you or was it mere a confirmation of already known practices?

No, I wasn't surprised. Having trained as a wealth manager—though I never practiced—then having interviewed 65 wealth managers in 18 countries, the Panama Papers confirmed what I'd learned and seen.

It was a bit jolting to find the leak came from the very office in Panama City where I had interviewed a practitioner about three years previously.

6. How can the supervision on the implementation of the EU-legislation be strengthened? Would you say that the member states have relevant supervising authorities or could more be done on EU-level?

   Are you asking whether the EU member states are implementing EU directives as intended? If so, then I don't know the answer. A political scientist or political sociologist specializing in the EU would probably be more helpful; as a sociologist specializing in global finance and professions, I don't really take a country-by-country perspective.

7. The EU does, obviously, not have the power to impose legislation on countries outside of the union. Do you have any suggestions on how the EU could ensure that secrecy havens apply global transparency standards?

   I think that's the wrong question. I'd recommend that you look at Jason Sharman's 2006 book, Havens in a Storm (Cornell U Press) on this subject. He explains why sanctions from international organizations haven't worked in "cracking down" on offshore financial centers.

   Sharman's analysis about the failure of the OECD's attempt to blacklist the secrecy jurisdictions into compliance comes down to three points:

   a) Many of these secrecy jurisdictions are former colonies, and they've been pushed and prodded for years to get on their own two feet economically. Now they've done it through engaging in the offshore financial services business, and they're being condemned for it.

   b) As the offshore centers see it, they have successfully outcompeted onshore states in terms of tax policy—the same states that have for years preached the virtues of capitalist competition. The onshore states seem to be sore losers now, crying "unfair tax competition" now that they aren't in the dominant position.

   c) Many of the onshore countries and leaders complaining the loudest about "unfair tax competition" are themselves deeply enmeshed in providing or using tax avoidance services. The UK and US, for example, are among the biggest and most successful tax havens in the world. As for individuals, the case of French finance minister Cahuzac, who had to resign following revelations that he was committing tax fraud via offshore structures, comes to mind as a recent example. The Panama Papers gave us many other embarrassing revelations of this nature.

   In essence, any onshore state or organization attempting to "impose" legislation or anything else on the offshore states is going to run into these problems of legitimacy. The EU should avoid repeating the problems that the OECD ran into when they tried imposing on the offshore centers.

8. According to you, will money laundering and tax evasion always move to new countries or are there possibilities to force a change, for example by

stricter regulation on which countries European banks and other intermediaries can conduct business with?

To really put a stop to money laundering and tax evasion—or even to legal tax avoidance on a massive scale, as we are seeing now—would require a level of international coordination that I don't think has ever been seen before. Even countries that are seen publicly to agree on measures to combat offshore financial abuses often turn out to be playing a double game: they themselves benefit from providing tax avoidance services to others.

This means that the incentives to "defect" from any international agreement are very strong, even among countries that are otherwise closely allied. How then to bring in countries that are not closely tied to the politics and interests of "onshore?" As long as that problem remains unresolved, there will always be some nations willing to accept financial business that is deemed illegal elsewhere. They have the sovereign right, of course, to make laws that ensure that the activity is legal in their jurisdiction—and they have plenty of professionals worldwide ready to help them write the laws that wealthy people would find most convenient to achieve their objectives.

So, as with question #7 above, I think the language here betrays an orientation that has demonstrably failed: the notion that the EU can "force a change" is as misguided as the notion that it can "impose" laws on countries outside of Europe. "Stricter" measures aren't needed: smarter ones are.